“Determinants of UK companies’ dividend policy”

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DETERMINANTS OF UK COMPANIES' DIVIDEND POLICY

Abstract

This study examines the major factors influencing UK companies listed on the Financial Times Stock Exchange (FTSE) 100 stock market's dividend policy (as determined by the dividend payout ratio) over 32 years, from 1990 to 2022. The dividend premium and free cash flow components make up the catering dividend. The outcomes of a wide range of panel data analysis regressions, such as Generalized Method of Moments (GMM) and Two-Stage Least Squares (2SLS) regressions, clearly show that the catering dividend significantly impacts UK firms' dividend policy. On the other hand, the dividend policy benefits from the dividend premium, which increases it by 12% to 17% on average. Free cash flow, on the other hand, has a negligible negative impact on the dividend policy by just 5%. It is crucial to mention that this outcome varies depending on the models and regression techniques used. Furthermore, this study emphasizes how important it is for a firm's size and profitability to play a key role in determining how it will implement its dividend policy. Financial leverage also becomes important since a company's dividend payment ratio decreases when it relies more heavily on debt in its capital structure. By using GMM and 2SLS regressions, this study carefully tackles the endogeneity issue, and the results hold up even when the endogeneity effect is reduced. Ultimately, this study emphasizes how important dividend catering components are in guiding UK companies' dividend policies, arguing that CEOs and legislators should pay more attention to this.

Keywords dividend, catering, FTSE, GMM, 2SLS, size, profitability, endogeneity

JEL Classification G35, G32, G11

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INTRODUCTION

Within corporations, the dividend policy is very important since it directly affects investor interest in the dividend amounts that they will receive. Investors are eager to learn about the company's strategies for keeping and allocating profits. Holding onto earnings enables reinvestment in the firm to support development and expansion. The dividend policy also has an impact on stock prices.

In the field of corporate finance, the analysis of dividend policy is a central focus that is extensively recognized and studied. This crucial component clarifies the relevance of dividends as a powerful signal to investors and offers insights into the current state of the business. Additionally, it is closely linked to the calculation of firm value. It is crucial to understand that the influence of dividend policy on company value goes beyond simple signaling and that the presence of customer dynamics only serves to reinforce this link. How dividend policy affects share prices, corporate risk, and dividend interactions highlights the significant impact that dividend policy has on the financial environment. As a result, there is a continuous need for in-depth observations in this field because the complex consequences of dividend decisions are still developing and need careful analysis.

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This important policy is influenced by several elements, the most notable of which is dividend catering, which includes the dividend premium and free cash flow. The difference between dividend payers and nonpayers is represented by the dividend premium, while the cash left over after investment withdrawals is known as free cash flow. Numerous studies have looked into these two variables and have found that the dividend premium has a steady, significant, and favorable impact over time. But the consequences of cash flow change over time; thus, these effects need to be reexamined.

1. LITERATURE REVIEW

In the early 1900s, dividends were regarded as concrete proof of a company's performance and were relied upon by shareholders for income. Annual cash payouts of dividends, which were set by the company statutes, were made. The origins of this practice date back to the 18th century. Profits influenced dividend payments, although there was not always a clear relationship because reserves had to be used for internal reinvestment in the business or in high-yielding stocks (Bataineh, 2022). If reserves were enough, larger parts of profits may be dispersed; however, losses frequently meant no dividends were paid. Dividends were seen by shareholders as a means of learning about the profitability and prospects of a company.

Lintner (1956) stated that corporate income is allocated among taxes, retained earnings, and dividends. Many scholars study catering theory in connection with dividend policy. The misinformed demand for dividends is caused by the dividend clientele proposed by Black and Scholes (1974), which is impacted by variables such as taxes and transaction costs.

Investors in the stock market have different views on risk when it comes to retained earnings and dividends. They suggest that companies should give in to the dividend preferences of their shareholders, as reported by Baker et al. (1985). Expanding on this, Baker and Wurgler (2004) presented the catering theory, which argues that companies distribute dividends in response to investor demand and withhold dividend payments in the absence of demand. Moreover, Li and Lie (2006), Lin et al. (2012), and Ali and Urcan (2012) have all endorsed the catering idea. On the other hand, some researchers (Hoberg & Prabhala, 2008; Von Eije & Megginson, 2008; Denis & Osobov, 2008) find no evidence supporting the catering theory. Subsequent studies found that, in developed countries, catering can account for variations in dividend propensity; however, this effect vanishes when risk is taken into account (Kuo et al., 2013). Research on emerging markets (Wang et al., 2016; Tangjitprom, 2013; Labhane, 2017; Twite et al., 2012; Rochmah & Ardianto, 2020; ElBannan, 2020) offers evidence in favor of the catering theory by markets. The catering theory of dividend policy has been supported by inconsistent evidence in the past, generally speaking. Dividend premium and free cash flow are the two categories into which dividend catering has been classified by the literature (Dickens et al., 2002; Amidu & Abor, 2006; Al-Malkawi, 2007; Bokpin, 2011).

Managers have the ability to optimize market value through dividend payments and modify them in response to catering incentives. This is shown in the cases of Midu and Abor (2006), Hoberg and Prabhala (2009), Yusof and Ismail (2016), Baker and Jabbouri (2016), and Kuzucu (2015). Moreover, several studies demonstrate a strong positive correlation between the dividend premium and the decision-making process regarding dividend adjustments (Riyanti & Yulianto, 2018; Tangjitprom, 2013). However, Ferris et al. (2009) found a strong negative association in developed countries.

According to certain studies, firms that have surplus free cash flow typically outperform others because of special chances (Rosdini, 2009; Dutta, 2009; Hussain, 2011; Al-Kayed, 2017). In addition, by paying dividends to shareholders, a large free cash flow helps companies manage uncertain times and lessens agency issues. In a similar vein, free cash flow has a major and favorable influence on dividend payments, according to a study that examines the variables affecting dividend payouts for corporations listed on the New Zealand Stock Exchange (Chen & Dhiensiri, 2009). This surplus of free cash flow, however, may cause disagreements between managers and shareholders about whether to reinvest in the company's assets rath-

er than pay out dividends. However, paying dividends can lessen the intensity of these disputes. Furthermore, numerous studies have discovered a significant correlation between dividend payments and free cash flow (Bulan et al., 2007; Chen & Dhiensiri, 2009; Arfan & Maywindlan, 2013; Arko et al., 2014). In contrast, research has shown that there is a substantial inverse link between dividend payments and free cash flow (Utami & Inanga, 2011; Al-Najjar, 2011; Patra et al., 2012; Botoc & Pirtea, 2014).

The following hypotheses are proposed based on the preceding literature:

H1: Dividend Premium has a positive relationship with the dividend policy of UK firms.

H2: Free Cash Flow has a negative relationship with the dividend policy of UK firms.

H3: Size and profitability are important variables that influence UK firms' dividend policies and are positively correlated with them.

H4: Financial Leverage is a significant factor that influences the dividend policy of UK firms and has a negative correlation with it.

2. METHOD

The dataset examined includes a range of companies listed in the FTSE 100 index and covers the period from 1990 to 2022. A methodical procedure is used to exclude companies that have incomplete annual data for two consecutive years throughout the production of this dataset. After careful processing, a refined sample of 47 firms is obtained, guaranteeing data consistency and integrity for the duration of the analysis. It is crucial to mention that every variable required for the analysis is carefully obtained from the DataStream platform, guaranteeing correctness and dependability in the subsequent research.

The model that was first developed and put into use by Adiputra and Hermawan (2020) and Susanti et al. (2020) is being used in the current analytical framework. This model provides the fundamental structure for the methods and analysis used in this study.

$$Divident\ policy = Catering\ dividents + Size + Profitability + Leverage. \quad (1)$$

$$Divident\ policy = Dividends\ premium + FCF + Size + Profitability + Leverage. \quad (2)$$

The principal aim of this model is to investigate the complex factors that influence the dynamics of dividend policy for firms that operate in the economic environment of the United Kingdom over a significant period spanning 1990 to 2022. Through a thorough analysis, the study aims to analyze and deconstruct the complex interactions between many factors that impact these companies' decisions about dividend payouts, providing insight into the changing patterns and trends over time.

The identification and scrutiny of the dividend payout ratio, precisely selected as the dependent variable, which intricately mirrors the dividend policy stance adopted by these UK-based firms, is at the heart of the analytical framework. This chosen metric is utilized as a robust proxy, enabling the strategic tendency and financial priorities adopted by these firms concerning dividend distributions to be gauged and interpreted by this paper.

Furthermore, this paper thoroughly analyzes and evaluates a wide range of factors and components that collectively represent dividend catering as part of the endeavor to completely comprehend the dynamics that support dividend policy. This paper specifically examines the dividend premium and free cash flow, which are selected with care as proxies, to shed light on the sophisticated processes and strategies that corporations employ to modify their dividend policy to meet stakeholders' diverse needs and expectations.

Moreover, this paper carefully evaluates and analyzes the effects of other firm-specific characteristics, such as size, leverage, and profitability, to provide a comprehensive view of the dividend policy environment. Through rigorous analysis and examination of these crucial factors, the complex network of connections and associations that guide UK companies' dividend policy choices is intended to be straightened, providing precious insights into the fundamental processes and forces influencing their calculated financial actions.

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Essentially, the model seeks to separate the complex web of variables influencing the dividend policy dynamics of UK firms during the long period from 1990 to 2022 by methodically applying a robust analytical framework and methodically assessing a wide range of variables and factors.

$$\begin{aligned} &Dividends\ payout\ ratio \\ &= \frac{Dividends\ per\ share}{Earnings\ per\ share}. \end{aligned} \quad (3)$$

The dividend payout ratio, an essential measure in financial analysis, provides insights into the dividends disbursed by a company relative to its earnings. It is computed by dividing the dividends per share by the earnings per share, thereby offering a quantitative perspective on the portion of earnings allocated towards dividend payments.

Furthermore, catering dividends, a concept integral to understanding corporate finance dynamics, are gauged through the examination of the dividend premium and free cash flow. The dividend premium reflects the extra dividends paid by a company beyond what is justified by its earnings, indicating a proactive approach to shareholder payouts. In parallel, free cash flow, another crucial indicator, displays the surplus cash available after accounting for operational and capital expenditures, which can be utilized for dividend distributions or other strategic initiatives.

$$\begin{aligned} &Dividends\ premium \\ &= \log\left(\frac{M}{B}\begin{pmatrix} ratio\ of \\ dividends \\ payers \end{pmatrix} - \frac{M}{B}\begin{pmatrix} ratio\ of \\ non\text{-}dividends \\ pfyers \end{pmatrix}\right). \end{aligned} \quad (4)$$

Where the dividend premium is the logarithmic difference between the market-to-book ratios of dividend payers and non-payers.

$$\begin{aligned} &Free\ cash\ flow\left(FCF\right) \\ &= \frac{\begin{pmatrix} Net\ operating \\ cash\ flow \end{pmatrix} + \begin{pmatrix} Net\ investment \\ cash\ flow \end{pmatrix}}{Total\ assets}. \end{aligned} \quad (5)$$

Where the net operating cash flows represent the cash flows from operating activities, and the net investment cash flow refers to the cash flows derived from investment activities.

Size represents the size of the firm, measured by taking the logarithm of the company's total assets.

$$\begin{aligned} &Profitability\ is\ the\ return\ on\ assets\left(ROA\right) \\ &= \frac{Net\ income}{Total\ assets}. \end{aligned} \quad (6)$$

Leverage involves using debt for financing and is measured by the debt ratio.

$$Debt\ ratio = \frac{Total\ liabilities}{Total\ assets}. \quad (7)$$

This study uses balanced panel data from the FTSE 100 market to investigate the factors influencing UK companies' dividend policies.

3. RESULTS

The descriptive statistics for the variables are shown in Table 1. There are 1,504 firm-observations of the variable "id". There is a standard deviation of 13.57 and a mean of 24 firms for "id". In addition, 47 and 1, respectively, are the highest and lowest number of firms. With 1,504 observations, the time-related variable "t" has a mean of 16.5 years and a standard deviation of 9.24. As a result, "t" values are between 1 and 32 years.

Table 1. Descriptive statistics

Variable	Obs	Mean	Std. Dev	Min	Max
id	1,504	24	13.56917	1	47
t	1,504	16.5	9.236164	1	32
DIV_PAYOUT	1,302	0.0367956	0.9556478	–2	3.60206
DIV_PREMIUM	1,472	1.858635	1.582515	0	11.27
FCF	1,475	0.1743162	0.139508	–0.2232665	0.8049967
SIZE	1,475	7.86912	1.140061	4.917364	11.36497
LEV	1,475	0.6406482	0.2243533	0	1.357
ROA	1,504	7.365392	7.121378	–20.82	38.42

We have 1,302 data points for "DIV_PAYOUT," representing the dividend payout ratio and indicating the dividend policy. "DIV_PAYOUT" has a mean of 0.0368 and a standard deviation of 0.9556. The values range from –2 to 3.6021 at the lowest and maximum, respectively. There are 1,472 observations for DIV_PREMIUM, a stand-in for catering dividend measurement. "DIV_PREMIUM" has a range of values from 0 to 11.27, with a mean of 1.8586 and a standard deviation of 1.5825. There are 1,475 observations included in the free cash flow or "FCF" variable. With a standard deviation of 0.1395 and a mean "FCF" of 0.1743, the possible values fall between –0.2233 and 0.8050. The "SIZE" variable represents the company's size and comprises 1,475 observations. 7.8691 is the mean "SIZE", while 1.1401 is the standard deviation. The "SIZE" variable has values between 4.9174 and 11.3650. There are 1,475 observations for the leverage variable, also known as "LEV". The mean "LEV" is 0.6406, and the standard deviation is 0.2244. "LEV" has values ranging from 0 to 1.357, where 0 is the lowest value, and 1.357 is the highest. Profitability is represented by the variable "ROA", which has 1,504 total observations. The mean "ROA" is 7.3654, and the standard deviation is 7.1214. The "ROA" values range from –20.82 to 38.42, in that order.

Now, this paper went further with the analysis, which was initiated by conducting the Breusch-Pagan LM test to compare random effects versus OLS (see Table 2).

Table 2. Breusch-Pagan LM test for random effects versus OLS

Variable	Coefficient	sd = sqrt (Var)
DIV_PAYOUT	0.9069374	0.9523326
e	0.0739798	0.2719922
U	0.431251	0.656697
Test: Var (u) = 0		
Chi-squared test stat = 11006.08		
Prob = 0.0000		

The Pooled OLS estimator and random effects models are compared using the Breusch-Pagan LM test, based on the null hypothesis, which states that the random effects estimator is the best model. The Pooled OLS estimator is chosen as the best model for this study, and the null hypothesis is rejected with a test statistic of 11006.08 and a P-value for the chi-square of 0.0000.

Table 3. Pooled OLS estimator

Variables	Coef	Std. Err
DIV_PREMIUM	0.1169058***	0.0138706
FCF	–0.5944183***	0.2082544
SIZE	0.6087605***	0.020869
LEV	–0.3917187***	0.110828
ROA	0.0382686***	0.0043343
Cons	–4.989848***	0.1975744
Firm FE	Yes	
Year FE	Yes	

Note: Dependent variable = Dividends Payout ratio *** indicates the coefficient is statistically significant at the 1% level (two-tailed tests). ** indicates the coefficient is statistically significant at the 5% level (two-tailed tests). * indicates the coefficient is statistically significant at the 10% level (two-tailed tests).

With a positive coefficient of 0.1169058 for DIV_PREMIUM, UK firms' dividend payout ratio is positively impacted by catering dividends. This coefficient, like other studies (Rochmah & Ardianto, 2020; Bilel & Mondher, 2020; Labhane, 2019; Baker & Wurgler, 2004), is highly statistically significant at the 1% level. This confirms the first hypothesis, which holds that dividend premiums positively impact the dividend policy of UK firms. Conversely, the catering dividend variable FCF exhibits an extremely significant negative coefficient of –0.5944183 at the 1% level. The outcome is consistent with earlier studies (Bogolebska, 2023; Labhane, 2019; Baker & Wurgler, 2004), so bolstering the second hypothesis, which posits that free cash flow negatively influences UK firms' dividend policy. The payout ratio is negatively impacted by the increased free cash flow since it is often invested rather than dispersed.

Additionally, the positive coefficient of 0.6087605 indicates that the company's size is crucial. This coefficient, which indicates that a firm tends to pay out more dividends as it grows, reflecting its establishment and desired expansion, is highly statistically significant at the 1% level. On the other hand, smaller firms have lower dividend payout ratios since they need more capital for growth. This conclusion confirms the third hypothesis, which holds that size has a substantial role in influencing the dividend policy of UK corporations, and is confirmed by earlier research (Bogolebska, 2023; Rochmah & Ardianto, 2020). Furthermore, as demonstrated by the extremely negative coefficient of –0.3917187, financial leverage has a negative impact on the dividend payout ratio. According to earlier studies (Kalash, 2023; Ramadani & Ratmono, 2023; Labhane, 2019), this

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coefficient is highly statistically significant at the 1% level and supports the fourth hypothesis, which states that financial leverage lowers dividend distribution. The amount of money available for dividend distribution is lowered by the company's interest payment obligations.

At the 1% level, the ROA variable exhibits a statistically significant very positive coefficient of 0.0382686. This suggests that when more net income is given to investors, profitability increases boosting the dividend payment ratio. This result is in line with other studies (Labhane, 2019; Ramadani & Ratmono, 2023; Bogolebska, 2023; Rochmah & Ardianto, 2020).

Table 4. Hausman test for fixed versus random effects model

Variables	Fixed	Random	Difference
DIV_PREMIUM	0.1532392	0.1532735	–0.0000343
FCF	0.0514685	0.0484676	0.0030009
SIZE	0.8659505	0.8457511	0.0201994
LEV	0.3040529	0.2793973	0.0246556
ROA	0.0176761		
Firm FE	Yes	0.0183405	–0.0006644
Year FE	Yes		
Test: H0: difference in coefficients not systematic			
Chi-squared test stat = 27.52			
Prob = 0.0000			

Note: Dependent variable = Dividends Payout ratio.

The fixed and random effects models are evaluated using the Hausman test, based on the null hypothesis that the random effects estimator is the best model. The chi-square p-value is 0.0000, and the test statistic is 27.52. These findings lead to infer that the fixed effects estimator is the more fitting model for this study and to reject the null hypothesis.

Table 5. Fixed effects or within estimator

Variables	Coef	Std. Err
DIV_PREMIUM	0.1532392***	0.0063511
FCF	0.0514685	0.0945085
SIZE	0.8659505***	0.0222835
LEV	0.3040529***	0.0659092
ROA	0.0176761***	0.0021821
Cons	–7.539675***	
Firm FE	Yes	0.1868517
Year FE	Yes	

Note: Dependent variable = Dividends Payout ratio *** indicates the coefficient is statistically significant at the 1% level (two-tailed tests). ** indicates the coefficient is statistically significant at the 5% level (two-tailed tests). * indicates the coefficient is statistically significant at the 10% level (two-tailed tests).

The conclusion drawn from the pooled OLS regression, which indicates that catering dividends (dividend premiums) improve the dividend policies of UK companies by raising their payout ratios, is supported by the results of the fixed effects estimation. According to earlier studies (Rochmah & Ardianto, 2020; Bilel & Mondher, 2020; Labhane, 2019; Baker & Wurgler, 2004), this result is in line with the first hypothesis, which asserts that dividend premium has a strengthening influence on the dividend policies of UK corporations. The board of directors determines dividend payments based on net income rather than free cash flow, hence the influence of free cash flow is unclear. The coefficient of free cash flow is very small in this case. This result runs counter to the arguments made by Baker and Wurgler (2004), Labhane (2019), and Bogolebska (2023). Moreover, Brexit in 2020 resulted in a structural change to UK companies' dividend practices. Unfortunately, this means that testing the second hypothesis is no longer possible.

However, a company's size also matters because bigger, more established, and more mature companies typically pay higher and more reliable dividends. This is consistent with the third hypothesis. Because higher debt levels translate into bigger tax savings and a higher dividend payout ratio, the tax shield effect helps to create a positive leverage effect. By raising net income, profitability also contributes to dividend stability, policy, and payout ratio.

Applying the First-differences estimator is suggested to account for the lag effect and assess the results' persistence. This adjustment is necessary because the lag effect can occasionally affect the accuracy of the results.

Table 6. First-differences estimator

Dependent Variables	Coef	Std. Err
DIV_PREMIUM	0.087487***	0.0040179
FCF.D1	–0.0189525	0.0476706
SIZE.D1	0.3237493***	0.0516099
LEV.D1	0.0253278	0.0746258
ROA.D1	0.0016869	0.0011818
Firm FE	Yes	
Year FE	Yes	

Note: Dependent variable = Dividends Payout ratio *** indicates the coefficient is statistically significant at the 1% level (two-tailed tests). ** indicates the coefficient is statistically significant at the 5% level (two-tailed tests). * indicates the coefficient is statistically significant at the 10% level (two-tailed tests).

Certain factors may still have unclear impacts even after lag effects are taken into account and the First-differences estimator is used. Notably, the most permanent variables are the size effect and dividend catering, especially the dividend premium, which are unaffected by the lag and cannot be altered. Given their positive and statistically significant effects on the dividend payout ratio at the 1% level, catering dividends, and size both result in a rise in the dividend payout ratio.

Table 7. Recovering individual-specific effects

Variable	Obs	Mean	Std. Dev	Min	Max
Alphafehat	1,285	4.02	0.7855422	–1.803496	2.004317

The alphafehat was anticipated to estimate impacts that are specific to each individual. The alphafehat, according to the research, has a range of values from –1.803496 at the minimum to 2.004317 at the greatest. Alphafehat's mean value is tiny, positive, and very near to 4. The good news is that there is a time-invariant effect inside each individual as the alphafehat remains constant throughout time for each individual (firm). This could be the result of missing variables, indicating a well-designed model specification. At 0.7855422, alphafehat's standard deviation is quite low.

In addition, a robustness check is performed, and an endogeneity test is conducted to detect endogeneity.

Table 8. Endogeneity test

Test of endogeneity
H0: Variables are exogenous
GMM C statistic Chi-Squared = 91.3087 (P = 0.0000)

The P-value is 0.000, and the test statistic is 91.3087. It is suggested that there is an endogeneity issue when the null hypothesis, which assumes that the variables are exogenous, is rejected. This result is in line with earlier research conducted by Dunca et al. (2004) and Hill et al. (2021).

Because of this endogeneity, two tests are conducted: the GMM and the instrumental variable regression, also known as two-stage least-square regression (2SLS), to account for endogeneity.

Table 9. Instrumental variables (2SLS) regression

Dependent Variables	Coef	Std. Err
CCC	–0.0026088***	0.0004586
DIV_PREMIUM	0.1256838***	0.017108
FCF	–0.5894866**	0.2575834
SIZE	0.593188***	0.0256203
ROA	0.0371792***	0.005336
LEV	–2.261722***	0.3567898
Cons	–3.736407***	0.3254222
Firm FE	Yes	
Year FE	Yes	
Instrumented CCC		
Instruments Ind Variables+ t+id		

Note: Dependent variable = Dividends Payout ratio *** indicates the coefficient is statistically significant at the 1% level (two-tailed tests). ** indicates the coefficient is statistically significant at the 5% level (two-tailed tests). * indicates the coefficient is statistically significant at the 10% level (two-tailed tests).

From Table 9, the cash conversion cycle variable was used as an instrumental variable; its coefficient is a highly significant negative instrument at the 1% level. This aligns with Tarkom and Yang (2023), who demonstrate the dependability of the findings following endogeneity correction and problem-solving. Except for the free cash flow, which is significant at 5%, all variables are significant at 1%. The only negative coefficients are leverage and free cash flow. Leverage will lower the net amount of funds available to shareholders by raising financial risk and requiring additional interest payments. The dividend payout ratio will drop due to the firm's improved investment strategy and policy brought about by the growth in free cash flow.

Table 10. GMM weight matrix: Robust

Dependent Variables	Coef	Std. Err
CCC	–0.0025777***	0.0004206
DIV_PREMIUM	0.144576***	0.0217764
FCF	–0.5097055*	0.2903401
SIZE	0.6040964***	0.0281218
ROA	0.0412309***	0.0056774
LEV	–2.290238***	0.3282681
Cons	–3.889787***	0.3273 262
Firm FE	Yes	
Year FE	Yes	
Instrumented CCC		
Instruments Ind Variables+ t+id		

Note: Dependent variable = Dividends Payout ratio *** indicates the coefficient is statistically significant at the 1% level (two-tailed tests). ** indicates the coefficient is statistically significant at the 5% level (two-tailed tests). * indicates the coefficient is statistically significant at the 10% level (two-tailed tests).

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Table 11. First-stage regression of weal instrument

Variable	Adj RSeq	Partial RSeq	Robust F(2,1267)	Prob > F
CCC	0.6186	0.1498	119.527	0.0000
Minimum eigenvalue statistic = 111.61				
2SLS 5% Wald test	19.93	11.59	8.75	7.25
LIML 5% Wald test	8.68	5.33	4.42	3.92

Except for leverage and free cash flow, all of the GMM's coefficients are positive and continuously raise the dividend payout ratio, providing results identical to those of the 2SLS. In the GMM model, the FCF is likewise marginally significant at the 0.10 level.

The last step is to run the First-stage regression to see whether the instruments are weak to ensure the objectivity of the results utilizing the instrumental variables models.

It is stated that robust and well-specified 2SLS and GMM models have been employed, with the null hypothesis that the instruments are weak being rejected. This results in reliable, impartial, and consistent outcomes. All the important values in Table 11 exceed the F statistic, which is 119.527.

The examination of the findings of the hypothesis testing provides important new information about the factors influencing dividend policies in UK firms. First, in line with earlier research findings, the study confirms the beneficial influence of dividend premiums on UK firms' payout policies. In contrast, Free Cash Flow (FCF), the main dividend variable, has a negative coefficient. This suggests that a larger FCF is more likely to be reinvested than paid out as dividends, which lowers the payout ratio.

Moreover, firm size becomes a crucial element impacting dividend policy, as bigger corporations tend to distribute larger dividends as they grow. This is consistent with the widely held belief that expanding businesses need more cash to expand, which reduces dividend payments. On the other hand, extant literature indicates that financial leverage harms dividend payout ratios, mainly because of the reduced available cash for dividends resulting from interest payment commitments.

The fixed effects estimation results show the reinforcing effect of dividend premiums on UK firms' dividend policy, corroborated by the pooled OLS regression findings. Free cash flow (FCF) does not, however, appear to significantly influence dividend decisions made by the board, which is largely motivated by net income. Specifically, the Brexit event in 2020 forced dividend programs to undergo structural changes, making it impossible to evaluate some of the predictions.

In addition, the positive correlation between firm size and dividend payouts is reaffirmed, with larger, more established firms generally having more stable dividend payments. Moreover, the tax shield effect boosts leverage by increasing dividend payouts because of the increased tax savings. Furthermore, profitability comes into play as a factor that supports dividend policy by increasing net income and, in turn, dividend stability. All things considered, the study offers thorough insights into the complex factors influencing dividend policy among UK firms, with important ramifications for both corporate finance theory and practice.

CONCLUSION

Using a large dataset covering the years 1990 to 2022, this study sought to investigate the factors influencing dividend policy for UK Companies. The study found that different dividend policies are impacted by catering dividends, notably dividend premiums and free cash flow. It was discovered that the dividend premium had a favorable impact, whereas free cash flow had a negative one. This is in line with the dividend signaling theory, which postulates that rising risk premiums have a fa-

vorable effect on dividends per share and raise stock returns as a result. On the other hand, market investors view a rise in free cash flow as a red flag regarding payout growth. In actuality, though, it strengthens the company's investment strategy rather than its dividend strategy, which validates the free cash flow hypothesis.

The study concludes that one of the most important factors in deciding on the payment strategy is catering dividends. The size effect is still present among UK corporations, meaning that as a company moves from the growth stage to the maturity stage, larger companies typically pay out more dividends. Furthermore, as profitability raises net income and impacts the board of directors' decision to distribute dividends, it is crucial in determining dividend policy. The pecking order theory states that using financial leverage and taking on more debt are crucial components of dividend policy setting. Leverage lowers agency costs but also comes with more responsibilities and interest payments. These factors limit net income, resulting in a smaller dividend policy and dividends per share. Crucially, steady, and trustworthy results are obtained by using GMM and instrumental variable regression to account for endogeneity effects.

This paper has implications for a wide range of stakeholders. For example, policymakers may find it useful to consider the dynamics of dividend policies for UK corporations when developing regulations and tax laws. The positive correlation between dividend premiums and policies that encourage risk-taking and investment may result in higher dividend distributions, which could affect stock market stability. Understanding the multiple consequences of providing dividends, especially dividend premiums and free cash flow can help regulatory organizations regulating financial markets create more effective regulatory frameworks. Legislators may take into account strategies to encourage companies to concentrate on raising profitability and efficiently managing free cash flow to meet market expectations and build investor trust. Lastly, these observations may be used by executives and firm boards to improve their dividend distribution plans.

AUTHOR CONTRIBUTIONS

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